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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1933.

No. 783

LOCAL LOAN COMPANY, A CORPORATION,
Petitioner and Appellant Below,

vs.

WILLIAM HUNT,
Respondent and Appellee Below.

BRIEF OF PETITIONER.

FREDERIC BURNHAM,
DAVID F. ROSENTHAL,
ORVILLE W. LEE,
RICHARD MAYER,
Counsel for Petitioner.

THE SUNTHORP-WARREN PRINTING COMPANY, 810 WEST JACKSON, CHICAGO

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BRIEF OF PETITIONER.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals appears on page 34 of the record and is reported in 67 Fed. (2d) 998. It is mainly a reaffirmance of the same court's opinion in *In re Skorcz,* reported in 67 Fed. (2d) 187. No opinion was rendered by the District Court.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered November 17, 1933 (R. 35). Certiorari was granted March 12, 1934 under Section 240a of the Judicial Code as amended by Section 1 of the Act of February 13, 1925 (c. 229, 43 Stat. 936, 938).

Statement of Case.

On September 17, 1930, William Hunt, the respondent herein, was in the employ of the Grand Trunk Western Railroad Company. On that day he borrowed $300 from the petitioner herein, the Local Loan Company, and executed an assignment of his wages earned and to be earned by him with said employer, as security for said loan. (R. 9.)

On March 3, 1931, Hunt filed a voluntary petition in bankruptcy in the United States District Court for the Northern District of Illinois, Eastern Division, in which he duly scheduled the debt of $300, and on March 6, 1931, Hunt was adjudicated a bankrupt. On March 10, 1932, he procured his discharge. (R. 9.)

On October 17, 1932, petitioner served notice of the aforesaid wage assignment upon Hunt's employer and on October 18, 1932, filed suit against said employer in the Municipal Court of Chicago, Illinois, on said assignment (R. 3, 6). In that suit the petitioner sought to recover wages earned by Hunt after his adjudication as a bankrupt.

On November 14, 1932, Hunt petitioned said District Court for an order permanently restraining petitioner from further prosecuting its said suit or its said claim under the wage assignment (R. 2). Petitioner answered setting up that the assignment was a valid lien not extinguished by a discharge in bankruptcy and contesting the jurisdiction of the District Court to issue the injunction (R. 5). A permanent restraining order was nevertheless issued (R. 8-10). Petitioner appealed to the Circuit Court of Appeals for the Seventh Circuit where the order of the District Court was sustained by judgment entered November 17, 1933 (R. 35).

Questions Presented.

1. Is it within the jurisdiction of a bankruptcy court, after it has granted a discharge in bankruptcy, to adjudicate the effect of such discharge upon a claim or demand made against the bankrupt by a person not a party to the bankruptcy proceedings? Petitioner claims it is not, that function being reserved to any court of general jurisdiction in which suit may be brought against the discharged bankrupt upon such claim or demand, in which court the discharge may be pleaded in bar to the action.

2. Has a bankruptcy court the right to oust, by permanent injunction, the prior possession by a court of general jurisdiction of a suit brought against a bankrupt, after discharge, upon an obligation from which the bankrupt claims to have been freed by his discharge? Petitioner asserts that such right is denied the bankruptcy courts by Section 265 of the Judicial Code, and is otherwise outside the jurisdiction of such courts.

3. May a bankruptcy court disregard decisions of the highest court of a state in determining whether in that state an assignment of future wages, or other encumbrance of property not *in esse*, creates such a lien as is preserved from discharge in bankruptcy by Section 67 (d) of the Bankruptcy Act? Petitioner believes that in such matters the bankruptcy courts are bound to follow the decisions of the highest courts of the several states.

The above are the three principal questions involved in this case, all of which were decided adversely to the petitioner and erroneously, as petitioner believes, by the District Court and by the Circuit Court of Appeals.

STATUTES INVOLVED.

Section 265 of the Judicial Code (March 3, 1911, c. 231, § 265, 36 Stat. 1162; 28 USCA 379):

> "The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy."

Section 2 (15) of the Bankruptcy Act (July 1, 1898, c. 541, § 2 (15), 30 Stat. 545; 11 USCA 11):

> "The courts of bankruptcy * * * are invested * * * with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings to * * * make such orders, issue such process and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title; * * *"

Section 11 (a) of the Bankruptcy Act (July 1, 1898, c. 541, § 11 (a), 30 Stat. 549; 11 USCA 29):

> "A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition against him, shall be stayed until after an adjudication or the dismissal of the petition; if such person is adjudged a bankrupt, such action may be further stayed until twelve months after the date of such adjudication, or, if within that time such person applies for a discharge, then until the question of such discharge is determined."

Section 67 (d) of the Bankruptcy Act (July 1, 1898, c. 541 § 67 (d), 30 Stat. 564; June 25, 1910, c. 412, § 12, 36 Stat. 842; 11 USCA 107):

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration * * * shall, to the extent of such present consideration only, not be affected by anything herein."

Summary of Argument.

Point I.—Bankruptcy courts are courts of limited statutory jurisdiction, exercising only such powers as are granted them in the Bankruptcy Act. They grant or refuse discharges in bankruptcy but it is not their function to pass upon the effect of a discharge, when granted, upon a particular obligation of a bankrupt. That function is reserved to any court of general jurisdiction in which a bankrupt may be sued and where he may plead his discharge in bankruptcy as a bar to the action. In this case petitioner was permanently enjoined by a bankruptcy court from prosecuting a claim against respondent, a discharged bankrupt, in a state court of general jurisdiction. The injunction constituted a final adjudication by the bankruptcy court of the effect of its own discharge upon petitioner's claim and for that reason was beyond the jurisdiction of the bankruptcy court.

Point II.—Courts of the United States are forbidden by Section 265 of the Judicial Code from enjoining proceedings in any state court except when authorized to do so by the Bankruptcy Act. In this case the state court had prior possession of the controversy between petitioner and respondent.

Neither expressly, nor by permissible implication, does the Bankruptcy Act authorize a bankruptcy court to permanently enjoin suits brought against a bankrupt in a state court.

Section 2 (15) of the Act invests bankruptcy courts with such equitable powers as are necessary to carry out their statutory jurisdiction, and no more. In this case the bankruptcy court exceeded its statutory jurisdiction not only in adjudicating the effect

of its own discharge, but in adjudicating the right of petitioner, claiming adversely to the bankrupt, to property not in the bankruptcy court's possession, and in entertaining litigation with respect to the title to property not a part of the bankrupt's estate. Its use of the writ was, therefore, in excess of the authority vested in it by Section 2 (15).

Section 11 (a) of the Act, the only other relevant provision, authorizes bankruptcy courts to stay suits pending against a bankrupt only until the bankrupt's application for discharge has been acted upon. This Section not only fails to authorize any permanent stay of such proceedings after discharge but manifests a contrary intention that after discharge the authority of the courts of general jurisdiction shall be restored.

Point III.—Not only had the bankruptcy court no jurisdiction to adjudicate the effect of respondent's discharge upon petitioner's claim, nor any right to employ the writ of injunction to oust the prior jurisdiction of the state court over that question, but in passing upon the question it erroneously failed to follow, as it should have done, the law in Illinois that an assignment of future wages creates a present lien against such wages in favor of the assignee. The Bankruptcy Act preserves from the operation of a discharge in bankruptcy all liens created by state law and in determining the nature and effect of such liens bankruptcy courts should follow the decisions of the highest courts of the several states.

ARGUMENT.

Point I.

It Is Not Within the Jurisdiction of a Bankruptcy Court, After Granting a Discharge in Bankruptcy, to Adjudicate the Effect of Such Discharge Upon a Claim or Demand Made Against the Bankrupt by a Person Not a Party to the Bankruptcy Proceedings.

Three Circuit Courts of Appeals have decided that it is not a function of the bankruptcy courts to pass upon the effect of a discharge in bankruptcy upon a particular obligation of a bankrupt, that function being reserved to the courts of general jurisdiction, in which the bankrupt may plead his discharge in bar when sued upon the obligation.

In re Marshall Paper Co. (1st C. C. A. 1900) 102 Fed. 872, 874.

Hellman v. *Goldstone* (3rd C. C. A. 1908), 161 Fed. 913.

In re Havens (2nd C. C. A. 1921), 272 Fed. 975, 976.

Contra is *Sims* v. *Jamison* (9th C. C. A. 1933), 67 Fed. (2d) 409, which holds that both courts of general jurisdiction and bankruptcy courts have jurisdiction in the matter. All of the District Court cases found in which the point has been squarely raised support the rule of the Circuit Courts of Appeals in the First, Second and Third Circuits.[1]

[1] *In re DeLauro* (D. C. Conn. 1932), 1 Fed. Supp. 678; *In re Madden* (D. C. N. J. 1919), 257 Fed. 581; *In re Weisberg* (D. C. Mich. 1918) 253 Fed. 833; *In re Lockwood* (D. C. N. Y. 1917), 240 Fed. 161; *In re Levitan* (D. C. N. J. 1915), 224 Fed. 241; *In re McCarty* (D. C. Ill. 1901) 111 Fed. 151; *In re Rosenthal* (D. C. N. Y. 1901), 108 Fed. 368; *In re Mussey* (D. C. Mass. 1900), 99 Fed. 71; *In re Black* (D. C. Cal. 1899), 97 Fed. 493.

We submit that the weight of reason as well as the weight of authority indicates that bankruptcy courts should not undertake to pass upon the effect of their own discharges. The necessity for such adjudications does not arise until a discharged bankrupt is sued or threatened with suit, in a court of general jurisdiction, upon some obligation incurred by him, or lien given by him, prior to his bankruptcy. Such court of general jurisdiction has the power to pass upon the effect of the discharge at that time. If the bankruptcy courts were to assume a concurrent power to decide the same issue whenever it might arise, such power could only be exercised summarily, as it was in this case, by injunction. Manifold objections to that form of procedure at once suggest themselves.

First. The effect of the discharge would often be only one of several issues arising between the parties. Since bankruptcy courts are neither equipped nor authorized to dispose of all of the issues which might be involved, the result would often be to delay the disposition of an entire cause in the court of general jurisdiction in which it had been or might be commenced, pending the final decision of a single issue in a bankruptcy court.

Second. It would result in the employment of the writ of injunction in a large class of cases involving no inadequacy of legal remedy. It must be assumed that the bankrupt's discharge would be accorded full effect if he should plead it in bar to whatever action might be brought against him in a court of general jurisdiction. Any possible failure of such court through error to accord proper effect to the discharge would be subject to correction through the usual channels of appeal.

Third. Such procedure would result in a useless duplication of legal machinery. Since the power and duty of enforcing discharges in bankruptcy is undoubtedly possessed by every court of general jurisdiction wherein the question might arise, there is no necessity for investing bankruptcy courts with the same power. In their special field of adjudicating the status of bankrupts and administering their estates for their creditors, bankruptcy courts perform an exclusive and specialized function, whereas in undertaking to exercise at least partial jurisdiction over every case in which the status of a bankrupt, once declared, might thereafter become material, such courts would be merely assuming cumulative jurisdiction over a matter of general law.

Fourth. Such procedure, if it became at all common, would greatly burden the bankruptcy courts, interfering with the expeditious dispatch of strictly bankruptcy matters. No bankruptcy case could ever be considered entirely closed as long as the bankrupt might at any time call upon the court to adjudicate the effect of his discharge whenever such question might arise between him and someone asserting a claim against him.

Further undesirable results would follow in cases where the controversy over the effect of the discharge had come into the possession of some court of general jurisdiction before the authority of the bankruptcy court was invoked. The conflict of jurisdictions which would arise in every such case is considered in Point II.

In this case, through a supposed jurisdiction summarily invoked, the District Court, sitting in bankruptcy, undertook to pass upon the effect of respondent Hunt's discharge in bankruptcy upon the

claim brought against him by petitioner, based upon an assignment of future wages given to petitioner by Hunt prior to his bankruptcy. We submit that upon the authority of the cases cited and for the various reasons above mentioned, the Circuit Court of Appeals should have held that in fact the District Court had no jurisdiction to pass upon such a question and should have vacated that court's injunction order.

Point II.

A Bankruptcy Court Has No Right to Oust, by Permanent Injunction, the Prior Possession by a Court of General Jurisdiction of a Suit Brought Against a Bankrupt After Discharge Upon an Obligation from Which the Bankrupt Claims to Have Been Freed by His Discharge.

Section 265 *of the Judicial Code*[1] provides:

> "The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy."

This section forbids interference by one court when the jurisdiction of another court of concurrent authority has attached, and is based upon the necessity of preventing unseemly conflict between state and federal courts. It is strictly enforced.

Peck v. *Jeness,* 48 U. S. (7 How.) 612, 624 (1849).

Metcalf v. *Barker,* 187 U. S. 165, 175 (1902).

Hull v. *Burr,* 234 U. S. 712, 723 (1914).

Phelps v. *Mutual Reserve Fund Life Assn.,* (6th C. C. A. 1901) 112 Fed. 453, 463-470 (aff'd. 190 U. S. 147).

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[1] Mar. 3, 1911, c. 231, § 265, 36 Stat. 1162; 28 USCA 379.

The *Phelps* case holds that the only permissible relaxation of the strict rule of Section 265 is that a federal court may enjoin a state court when necessary to protect its own prior possession of a controversy or enforce its own judgment.

In this case the state court, not the bankruptcy court, had prior possession of the controversy over Hunt's wages earned subsequent to his adjudication. There was no controversy until petitioner asserted, after Hunt's discharge, its claim against such wages in the hands of his employer. Petitioner was in no sense a party to any proceedings theretofore had in the bankruptcy court. Therefore it cannot reasonably be claimed in this case that the bankruptcy court had a prior possession of the controversy, to protect which it might enjoin the proceedings begun by petitioner in the state court.

Similarly, it cannot be claimed that the bankruptcy court, in issuing the injunction in this case, acted to enforce its own prior judgment. Since the controversy between petitioner had not theretofore arisen, it could not possibly have been adjudicated by any judgment or order theretofore made by the bankruptcy court.

Because the injunction issued in this case does not come within the scope of any implied exception to Section 265 of the Judicial Code, the sole remaining question is whether it comes within the express exception to that section by reason of being authorized by any provision of the Bankruptcy Act. The only two provisions of the Act which are relevant are Sections 2(15) and 11(a), and it was stated in *Hull* v. *Burr*, 234 U. S. 712, 723 (1914), that those sections are now the "laws relating to bankruptcy" to which Section 265 of the Judicial Code refers.

Section 2(15) of the Bankruptcy Act[1] provides:

> "The courts of bankruptcy * * * are invested * * * with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings to * * * make such orders, issue such process and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title; * * *"

By the above section courts of bankruptcy are not invested with general equitable jurisdiction, but only such equitable powers as are necessary to carry out their statutory jurisdiction in bankruptcy matters.

Bardes v. *Hawarden Bank*, 178 U. S. 524, 535 (1900).

In re Judith Gap Commercial Co. (9th C. C. A., 1925), 5 Fed. (2d) 307, 309.

Since Section 2(15) does not of itself invest bankruptcy courts with any substantive jurisdiction, but only with procedural power to effectively exercise such jurisdiction as it otherwise possesses, it begs the question to point to that section alone as authority for the issuance of the injunction in this case. Other provisions of the Act must be consulted to determine whether the substantive result which the injunction achieved was a thing which bankruptcy courts are authorized to do.

We have heretofore asserted that the principal object of the injunction in this case, to adjudicate the effect of a bankrupt's discharge, is not a function which bankruptcy courts are authorized to perform (Argument, Point I). There are other reasons why the injunction did not perform a bankruptcy function.

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[1] July 1, 1898, c. 541, § 2 (15), 30 Stat. 545; 11 USCA 11.

Bankruptcy courts have no jurisdiction to adjudicate the rights of one who claims, adversely to the bankrupt, property not in the court's possession, even though it is part of the bankrupt's estate. Such an adverse claim must be litigated in a plenary proceeding in a court of general jurisdiction.

Bardes v. *Hawarden Bank,* 178 U. S. 524, 532 (1900).

Louisville Trust Co. v. *Comingor,* 184 U. S. 18, 25 (1902).

Harris v. *First National Bank,* 216 U. S. 382 (1910).

Galbraith v. *Valley,* 256 U. S. 46 (1921).

Harrison v. *Chamberlin,* 271 U. S. 191, 193 (1926).

An assignee claiming wages earned subsequent to adjudication is an adverse claimant within the foregoing rule.

Progressive Building & Loan Company, Inc. v. *Hall* (4th C. C. A. 1914), 220 Fed. 45, 46, 48.

Copeland v. *Martin* (5th C. C. A. 1910), 182 Fed. 805, 808.

Moreover, the wages in this case were earned after adjudication and therefore were not even part of Hunt's estate in bankruptcy. Bankruptcy courts have no power to entertain or enjoin litigation between a bankrupt and a third party with respect to property not a part of the bankruptcy estate. That is true where the property has been set aside to the bankrupt as an exemption,

Duffy v. *Tegeler* (8th C. C. A. 1927), 19 Fed. (2d) 305, 308.

B. F. Roden Grocery Co. v. *Bacon* (5th C. C. A. 1904), 133 Fed. 515.

and where the property is held by the bankrupt wrongfully, without title,

In re Amy (2nd C. C. A. 1920), 263 Fed. 8, 11.

A bankruptcy court's lack of jurisdiction upon both of the above grounds was recently recognized in a wage assignment case by the District Court, Eastern District of New York, in *In re Rashbaum*, 4 Fed. Supp. 724.

Having thus arrived at the conclusion that the entire subject matter affected by the bankruptcy court's injunction in this case was outside that court's jurisdiction for several reasons, it follows irresistibly that Section 2(15) of the Act cannot be invoked as authority for the issuance of the injunction.

Nor can the order of the District Court be sustained under Section 11(a) of the Bankruptcy Act[1] which provides:

> "A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition against him, shall be stayed until after adjudication or the dismissal of the petition; if such person is adjudged a bankrupt, such action may be further stayed until twelve months after the date of such adjudication, or, if within that time such person applies for a discharge, then until the question of such discharge is determined."

A stay under this section cannot delay the prosecution of a suit longer than the determination of the application for a discharge.

In re Byrne (2nd C. C. A., 1924), 296 Fed. 98, 101.

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[1] July 1, 1898, c. 541, § 11(a), 30 Stat. 549; 11 USCA 29.

In re Federal Biscuit Co. (2nd C. C. A. 1914), 214 Fed. 221, 225.

and several District Court decisions.[2]

We submit that Section 11(a) fails to affirmatively authorize the issuance of a permanent injunction to stay proceedings against a bankrupt after discharge, as was done in this case. Such an injunction therefor comes squarely within the prohibition of Section 265 of the Judicial Code. We further submit that Section 11(a) bears out all that we have said concerning a bankruptcy court's complete lack of jurisdiction to issue such an injunction. The clear purpose of the section is not to oust any court of general jurisdiction of its possession of any suit against a bankrupt, nor to usurp the power of any such court to adjudicate the effect of such bankrupt's discharge, when and if granted, but merely to hold such suits in suspense long enough to allow a bankruptcy court to determine whether or not a discharge will be granted. Section 11(a) indicates a legislative intent that courts of bankruptcy are not to charge themselves with perpetual custody of bankrupts, but that having granted discharges to them, they are to remit them to the protection of courts of general jurisdiction, there to have and enjoy whatever advantages the law gives them by reason of having been discharged in bankruptcy.

This conclusion is strengthened by the construction which the courts have given to Section 9 of the

[2] *In re Madden* (D. C. N. J. 1919), 257 Fed. 581; *In re Weisberg* (D. C. Mich. 1918), 253 Fed. 833; *In re Lockwood* (D. C. N. Y. 1917), 240 Fed. 161; *In re Flanders* (D. C. Vt., 1903), 121 Fed. 936; *In re Rosenthal* (D. C. N. Y. 1901), 108 Fed. 368.

Bankruptcy Act,[1] which invests courts of bankruptcy with power to protect bankrupts from arrest under civil process. It is held that the protection extended to bankrupts under that section expires with the granting or refusal of a discharge.

In re DeLauro (D. C. Conn. 1932), 1 Fed. Supp. 678, 680.

In re Lockwood (D. C. N. Y. 1917), 240 Fed. 161.

The conclusion is that since no power in the District Court to issue the injunction in this case is expressed in or can be implied from any provisions of the Bankruptcy Act, the injunction must be one which comes directly within the prohibitive language of Section 265 of the Judicial Code.

Moreover, such conclusion is the only one compatible with the fundamental principles of comity upon which Section 265 is based. In *Phelps* v. *Mutual Reserve Fund Life Ass'n.*, (6th C. C. A. 1901) 112 Fed. 453, affirmed 190 U. S. 147, the court said:

> "It is a rule of almost universal application that, between courts of the same sovereignty and concurrent jurisdiction, the court which first acquires jurisdiction of the controversy or of the res should be suffered by every other court to decide every question within the sphere of the pending cause, and to continue in the possession of the subject-matter of the controversy until every question before it shall be decided and the res discharged from its control. This rule has its foundation, perhaps, in comity; but the fruits of its recognition have been so beneficient, when applied to courts of concurrent jurisdiction created by different sovereignties, as to justify the conclusion that it is not only a rule of comity,

[1] July 1, 1898, c. 541, § 9, 30 Stat. 549, 11 USCA 27.

but one of necessity. The cases are numerous which recognize its binding force and illustrate its wide application. * * * The courts of the state and of the United States are, as to each other, foreign courts. Nevertheless the power sometimes exercised by courts of equity to restrain parties within their jurisdiction from proceeding in a foreign court does not apply to them, and it has long been recognized that state courts cannot enjoin proceedings in the courts of the United States, nor the latter in the former courts. Story, Eq. Jur. §§ 899, 900; *Bank* v. *Stevens*, 169 U. S. 436, 462, 463, 18 Sup. Ct. 403, 42 L. Ed. 807. Section 720 [Section 265 of the Judicial Code] originated in 1793, and is a legislative command affirmatively enforcing this rule of comity by expressly prohibiting the enjoining of proceedings in state courts, except when authorized in bankrupt cases. * * * (pp. 464, 465.)

To prevent such unnecessary conflicts of jurisdiction as that presented on this record, the statute (now section 720, Rev. St.) was enacted. The burden is upon one who asserts an interpretation of that provision which would tend to weaken its force and defeat its beneficient purposes. The spirit of the rule of comity between courts prevents interference, not upon any question of ultimate right or wrong, but upon the question as to which jurisdiction had first attached." (pp. 467, 468.)

If bankruptcy courts were permitted, by writs of injunction, as was done in this case, to oust the prior possession by a state court of general jurisdiction of a controversy over which the jurisdiction of the two courts is at most only concurrent, the result would be just such an "unnecessary conflict of jurisdiction" as Section 265 of the Judicial Code is primarily intended to prevent.

For the reasons stated the Circuit Court of Appeals should have set aside the order of the District Court in this case.

Point III.

A Bankruptcy Court May Not Disregard the Decisions of the Highest Court of a State in Determining Whether in That State an Assignment of Future Wages Creates Such a Lien As Is Preserved from Discharge in Bankruptcy by Section 67 (d) of the Bankruptcy Act.

Without in any way waiving its contention that the District Court had no jurisdiction to pass upon the merits of the question presented to it, petitioner also submits that it decided the issues incorrectly. Petitioner, by the assignment of wages given by respondent prior to his adjudication, acquired such a lien as is exempted by the provisions of Section 67 (d) of the Bankruptcy Act from the operation of the bankrupt's discharge.

Section 67 (d) of the Bankruptcy Act[1] provides:

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration, * * * shall, to the extent of such present consideration only, not be affected by anything herein."

The liens referred to in the above section are such as are created by the laws of the several states. The federal courts follow the decisions of the highest courts of the several states in determining the force and effect of liens created under state law.

Peck v. *Jeness*, 48 U. S. (7 How.) 612, 620 (1849).

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[1] July 1, 1898, c. 541, § 67(d), 30 Stat. 564, 11 USCA 107.

Dooley v. *Pease,* 180 U. S. 126, 128 (1901).
Thompson v. *Fairbanks,* 196 U. S. 516, 522 (1905).
Humphrey v. *Tatum,* 198 U. S. 91 (1905).
Hiscock v. *Varick Bank of New York,* 206 U. S. 28, 37 (1906).
Benedict v. *Ratner,* 268 U. S. 353 (1925).
In re Robert Jenkins Corporation (1st C. C. A. 1927) 17 Fed. (2d) 555.
In re Simpson (9th C. C. A. 1929), 35 Fed. (2d) 840.
Sims v. *Jamison* (9th C. C. A. 1933), 67 Fed. (2d) 409.

All of the above cases, except *Dooley* v. *Pease,* are bankruptcy cases, and all of those except the *Hiscock* case involve the validity of a lien given upon property to be acquired in the future. Judge Sparks, in *In re Skorcz,* (7th C. C. A. 1933), 67 Fed. (2d) 187, adopted by the same court as its opinion in this case (R. 34), recognized that his decision was contrary to the Illinois law of wage assignments, but relied upon *Swift* v. *Tyson,* 41 U. S. (16 Peters) 1, 17 and *Guffey* v. *Smith,* 237 U. S. 101, 114, where it was held that in common law actions the Federal courts are not bound by local decisions on points of general law. In view of the cases cited above it cannot be supposed that this court has ever considered that the doctrine of *Swift* v. *Tyson* applies in a bankruptcy case where the nature and extent of a lien are in question.

The Supreme Court of Illinois holds that in Illinois an assignment of future wages creates such a lien as gives the assignee a vested property right from the date of the assignment, and that such a

lien is within the terms of Section 67 (d) of the Bankruptcy Act, and is therefore not invalidated by the assignor's discharge in bankruptcy.

Mallin v. *Wenham*, 209 Ill. 252, 70 N. E. 564.

Monarch Discount Co. v. *C. & O. Railway Co.*, 285 Ill. 233, 120 N. E. 743.

Such being the law in Illinois, the District Court should have applied it in this case, and held that the bankrupt's discharge was not a bar to petitioner's suit upon the wage assignment in the Municipal Court of Chicago. We have in mind, of course, that the Federal courts in a number of cases involving the effect of the assignor's discharge in bankruptcy upon a wage assignment, have held that such assignment does not create a lien upon future wages until the wages are earned.[1]

Several of these cases criticize the Illinois doctrine.[1] None of them, however, arose in a jurisdiction where the Illinois doctrine prevails, and conse-

[1] *In re West* (D. C. Or., 1904), 128 Fed. 205; *In re Home Discount Co.* (D. C. Ala. 1906) 147 Fed. 538; *In re Ludeke* (D. C. N. Y. 1909), 171 Fed. 292; *In re Lineberry* (D. C. Ala. 1910), 183 Fed. 338; *In re Fellows* (D. C. Okla. 1930), 43 Fed. (2d) 122; *In re Vorhees* (D. C. Ohio, 1930), 41 Fed. (2d) 81; *In re Potts* (D. C. Ida. 1931), 54 Fed. (2d) 144; *Seaboard Small Loan Corp.* v. *Ottinger* (4th C. C. A. 1931), 50 Fed. (2d) 856.

[1] Of interest is "Wage Assignments in Illinois" by A. Fortas, in Yale Law Journal, Vol. XLII No. 4 (February, 1933), pages 527-548, where the conflicting cases are noted, and Professor Williston (Contracts, 1925, Sec. 414) and Restatement of Contracts (A. L. I. 1932), Sec. 154, are cited to the effect that the Illinois rule is technically sound. The decisions contra are characterized as variations introduced by the supposed "hardship of the case." And to the same effect is "Discharge in Bankruptcy and the Assignment of Future Wages," by F. M. Merrifield, in Univ. of Chicago Law Review, Vol. I, No. 3 (January, 1934), pages 488-490.

quently none of them passed upon the question of whether the bankruptcy courts are bound to follow the local rule in jurisdictions where it *is* the law that a wage assignment gives the assignee a present vested right in the assignor's unearned wages.

Although the decisions in these cases are not, for the reason stated, controlling in this case, the language used in many of them goes further than was necessary to sustain the decisions and lays down a supposed principle of law upon which respondent in this case relied heavily below, and which seems to have governed the Circuit Court of Appeals in its decision of this case.[1] That supposed principle is that it is impossible to create a present lien against wages to be earned in the future, and that an assignment of such wages cannot be more than a mere agreement for a lien which will have no actual existence until and unless the wages are actually earned. If that were a sound principle it might follow, as some courts have thought it must, that when an assignor of future wages becomes a bankrupt before such wages are earned, the assignee thereof has not yet acquired such a lien right as can be preserved to him by the operation of Section 67(d) of the Bankruptcy Act.

Respondent has not denied in this case that the Supreme Court of Illinois has solemnly declared that there may be a present lien upon future wages, and that by the giving of an assignment of such wages in Illinois, such a present lien is in fact created. Respondent instead has contended that despite the decision of the Supreme Court of Illinois, such a thing, by its very nature, cannot be. We believe that

[1] See opinion of Judge Sparks in *In re Skorcz* (7th C. C. A. 1933) 67 Fed. (2d) 187, 188-90, adopted by the same court as its opinion in this case (R. 34).

in this respondent is in error, and we submit that the Circuit Court of Appeals in this case went astray in relying upon such a doctrine.

The most representative statement of the supposed impossibility of a lien upon unearned wages is found in *Seaboard Small Loan Corporation* v. *Ottinger* (4th C. C. A. 1931), 50 F. (2nd) 856, 857, relied upon by the Circuit Court of Appeals in this case,[1] where it was stated (p. 857):

> "The rule is that an assignment of wages to be earned in the future is not good at law because ineffective to pass legal title, but will be enforced in equity. It is enforced in equity, not as a conveyance in præsenti of what manifestly does not exist, but because it is regarded in equity as a contract to take effect and attach to the wages assigned as soon as they come in *esse*. Until the wages are earned, it is regarded as an agreement to convey; after that time as a conveyance. * * *
>
> It is true that the rights of lienors under existing liens not forbidden by the Bankruptcy Act are preserved by that act; but the trouble here is that there was no lien on the wages in question existing at the time of the filing of the petition in bankruptcy. The loan company held nothing but a debt against the bankrupt, and a contract providing for the creation of a lien in the future when wages should be earned. Before this contract could give rise to a lien, its obligation was discharged by the bankruptcy; and the debt, without which no lien could exist, was discharged also."

The court in the Ottinger case cited a number of prior decisions, relying particularly upon *In Re*

[1] See opinion of Judge Sparks in *In re Skorcz* (7th C. C. A. 1933) 67 Fed. (2d) 187, 188-190, adopted by the same court as its opinion in this case (R. 34).

West (D. C. Oregon, 1904), 128 Fed. 205, where the court said in part:

> "The theory of a lien upon the earnings of future labor is not that it attaches to such earnings from the moment of contract, of pledge or assignment, but from the moment of their existence. It is needless to say that there can be no lien upon what does not exist."

The notion that there can be no lien upon something which does not exist is demonstrably fallacious. Even at common law a lien upon live stock attached to the increase thereof. In many states mortgages of after-acquired chattels are perfectly valid. In some states mortgages of unplanted crops are valid. One such mortgage was enforced by this court in *Butt* v. *Ellett*, 86 U. S. 544 (1873).

That a chattel mortgage upon unplanted crops, if by the law of the State wherein it is created it gives the mortgagee a present lien upon such crops, will be preserved from discharge in bankruptcy was clearly stated in the recent decision of the Ninth Circuit Court of Appeals in *Sims* v. *Jamison*, 67 Fed. (2nd) 409, 410. That court clearly recognized the duty of bankruptcy courts to follow the decisions of the State courts in such matters.

Unearned wages in an existing employment are not distinguishable in nature from other types of property having no actual existence, but having a potential existence sufficient to enable them to be earmarked and subjected to rights of ownership which will attach to them as soon as they come into existence. We believe that some courts have been misled by the unobjectionable statement that no lien can *attach* to property not in existence. To say that a right cannot presently *attach* to property is, however,

far different than saying that it cannot be presently *created* against the property.

To hold that an assignment of future wages is a mere contract to give a lien in the future is to disregard facts in support of a theory. If that were really true, such an assignment would bind the assignor to do some future act, when the wages had been earned, which would then create a lien against them, and, in in default of his doing that act, the assignee would have an action for damages for breach of contract. Of course, such is not the nature of a wage assignment. Whatever rights it creates come into being when the assignment is executed. If it creates a lien at all, it must create it at that time. It contains no promise that the assignor will do any future act. It is enforced upon the theory that the assignee's right to receive the assigned wages is based upon the original instrument of assignment.

We do not deny that it may be the law in any given jurisdiction that a lien cannot be created against property not in existence, nor that it is the law in many jurisdictions that no lien is created against future wages by an assignment thereof. We deny only that there is any reason why such must be the law in every jurisdiction. The Supreme Court of Illinois has held that a lien can be created in Illinois against unearned wages. There is nothing about the nature of a lien which makes such a result impossible. A lien has no physical existence so that it must inhere in some tangible property, but is a mere right, an intangible thing which exists solely by legal definition. It is a right to subject certain property to the payment of a debt, and if the property to which it is to attach can be sufficiently identified to be set aside and subjected to the lien when

and if it comes into existence, it need have no present actual existence.

The Circuit Court of Appeals in this case justified its decision by reasoning from general principles according to the following syllogism:[1]

> (a) The Bankruptcy Act supercedes all states laws upon the subject of bankruptcy.
>
> (b) The broad purpose of the Bankruptcy Act is to give bankrupts a fresh start free from debts.
>
> (c) Therefore, any state law which results in impressing a lien upon wages earned by a bankrupt, or other property coming into his possession, after his adjudication must be in conflict with such broad purpose of the act and therefore unenforcible.

In support of its reasoning the court relies upon *Board of Trade* v. *Johnson,* 264 U. S. 1 (1924); *Board of Trade* v. *Weston* (7th C. C. A. 1917) 243 Fed. 332; *Williams* v. *U. S. Fidelity & Guaranty Co.* 236 U. S. 549 (1915) and *In re Voarhees,* (D. C. Ohio 1930) 41 Fed. (2d) 81.

We can admit the premises of the court's argument but not that the conclusion follows or that it is justified by the authorities relied upon.

In *Chicago Board of Trade* v. *Johnson,* 264 U. S. 1 (1924) the question was whether a membership in the Chicago Board of Trade was property, within the definition of Section 70 of the Bankruptcy Act,[2] which passed to the creditors of the bankrupt. This court said that it was, disregarding a contrary decision of the Supreme Court of Illinois. In Section 70 of the Act Congress expressly undertook to define

[1] *In re Skorcz* (7th C. C. A. 1933) 67 Fed. 187, 189, adopted by the same court as its opinion in this case (R. 34).

[2] July 1, 1898, c. 541, 30 Stats. 565.

"property." It having done so, that question became one of federal law and this court rightly held that the bankruptcy court was not bound to follow the decision of the Illinois court. In this case, on the contrary, Congress has left to the several states the definition of "liens," merely providing in Section 67 (d) of the Act that all such liens shall be preserved. The decisions of the Illinois court upon that question are therefore decisions upon matters of local lien law, as to which this court has repeatedly held that the decisions of local courts shall control.

The *Johnson* case has no application to this case except that it supports the first premise of the Circuit Court of Appeals—that when Congress has spoken upon a matter of bankruptcy law, all contrary state law must be disregarded.

Board of Trade v. *Weston* (7th C. C. A. 1917) 243 Fed. 332, involves the same question as the *Johnson* case.

The second premise of the Circuit Court of Appeals' argument is supported by *Williams* v. *U. S. Fidelity & Guaranty Co.*, 236 U. S. 549 (1915), holding that the broad purpose of the Bankruptcy Act is to give debtors a fresh start, free from debt. With that proposition no one would quarrel. The *Williams* case has no other application here, involving as it does only the question of whether a discharge in bankruptcy acquits the obligation between a bankrupt and his surety.

In proceeding to its conclusion the Circuit Court of Appeals relies upon *In re Voorhees* (D. C. Ohio 1930) 41 Fed. (2d) 81, wherein it was held that it is inconsistent with the "broad purpose of the Bankruptcy Act to give the wage earner a fresh start" to

permit the existence of a lien upon wages earned by a bankrupt after adjudication.

A careful examination of the opinion in the *Voorhees* case reveals that that court's basis for finding such inconsistency is not convincing. The court said:

> "The assignment is ancillary or auxiliary only to the debt or obligation which it is to secure, and it seems to us that when the main or primary obligation is actually discharged and extinguished by the Bankruptcy Act, it must likewise follow that the assignment is annulled and becomes unenforceable."

If that statement were true, as of course it is not, no lien could survive a discharge in bankruptcy, for in every case the underlying debt is discharged. The court went on to say:

> "Such construction is in harmony with other decisions which deny to liens the effect of attaching to after-acquired property."

We have seen that as a matter of fact in many jurisdictions liens upon property not yet in existence are perfectly valid. The court then fell back upon the doctrine of *In re West* (D. C. Ore. 1904) 128 Fed. 205, and said that there can be no lien upon future wages because they are not *in esse*. Having arrived at that conclusion the court proceeded to reason that if the state law of Ohio should attempt to preserve the force of a wage assignment from being wiped out by a discharge in bankruptcy, it would amount to an invalid attempt to modify the provisions of the Bankruptcy Act. The court considered the Ohio wage loan statute not as one which created a lien, so that Section 67 (d) of the Bankruptcy Act would apply, but as one which attempted to keep alive a simple contract obligation in contravention of the

Act. In Illinois no such meaning can be read into the local law. The local law, as stated by the local courts, does not attempt to save from discharge a contract which the Bankruptcy Act says shall be discharged, but declares that a wage assignment creates a lien such as by the express terms of Section 67 (d) of the Bankruptcy Act is saved from discharge. We submit that the *Voorhees* case is not sound law.

The fallacy in the argument of the Circuit Court of Appeals is that this case cannot be decided upon the "broad principles" of the Bankruptcy Act because the Act contains a specific provision, Section 67 (d), which controls this case. If the Act undertook to define "liens" the situation would be entirely different. Such a provision would have to be construed, as a matter of federal law, in harmony with the whole purpose of the act. However, it does not do so, but leaves such definition to the state courts.

Moreover, there is no sound basis for saying that the broad purpose of the Act—to give debtors a fresh start—is entirely free of limitations. That objective is undoubtedly a beneficient public purpose, but there is a conflicting public benefit to be conserved by the preservation of liens given by debtors as security. Without such liens the flow of credit would be much impeded and credit, we are coming to understand, is the economic life-blood of the nation. The Act may well have been drafted with this countervailing public policy in mind.

It is apparent to anyone reading the opinions of the lower Federal Courts that a great deal of prejudice has entered into their decisions in wage loan cases. A wage debtor is commonly pictured as the

victim of a harsh and oppressive contract, ground between the millstones of the disapproval of his employer and the importunities of his creditor. The history of wage lending perhaps makes this attitude understandable, but it is not applicable to the facts in this case. The wage assignment here involved was made under the provisions of the Illinois Small Loan Act, which regulated all of its terms. There is no showing that it was not based upon ample consideration, that the rate of interest charged was excessive or that petitioner took advantage of any necessity of respondent to induce him to borrow money from it. Respondent will not be actually deprived of any of his wages by subjecting them to petitioner's lien, for he has in effect drawn them in advance, and doubtless has spent them and enjoyed the fruits thereof before going through bankruptcy.

The opportunity of borrowing against his future earnings is often of inestimable value to the wage earner. Our industrial civilization has developed such uncertainties of economic existence that the ability to obtain credit in times of need is of great importance. A man of property can borrow money by pledging his tangible wealth, but a laboring man often has no wealth except his ability to work. The opportunity of borrowing against that ability increases the flexibility of a wage earner's resources and gives him a credit reserve upon which to draw in emergencies. If wage earners can be permitted to borrow against their future earnings and then immediately wipe out the security by going through bankruptcy, wage lending will be greatly restricted, thus depriving of credit a class of persons who often desperately need it. Moreover, the increased risk to lenders will do much to offset what has been accom-

plished in making credit available to wage earners at a reasonable cost.

It should not be overlooked that wage earners are not the only class of persons who will be affected by the decision in this case. The credit resources of farmers and fruit growers, who often find it necessary to borrow upon the security of future crops, will also be profoundly affected. The social desirability of making such credit available to them, both from private and from public sources, is currently of great importance.

In summary of Point III., we submit:

1. Section 67 (d) of the Bankruptcy Act preserves from destruction by discharge in bankruptcy the liens created by the laws of the several states.

2. Whatever may be the law in other states, the law in Illinois is that an assignment of future wages creates a present lien against such wages, which will attach to them immediately upon their coming into existence.

3. Despite the doctrine of the *Ottinger* case, the *West* case and other cases noted above, which was adopted by the Circuit Court of Appeals in this case, there is in fact no valid reason why such may not be the law in Illinois.

4. It is well settled that bankruptcy courts, in passing upon the nature and extent of liens created by state law, should follow the decisions of the highest courts of the several states.

5. These clear principles of law should not be tampered with for shadowy reasons of supposed public policy, for it is by no means certain that public policy is not best served in the end by protecting liens upon property not *in esse* through a literal ap-

plication of the plain provisions of the Bankruptcy Act.

We respectfully submit that the Circuit Court of Appeals in this case erred in failing to follow the above principles and in failing to hold that petitioner had a lien against wages earned by the respondent after his adjudication as a bankrupt which was not destroyed by respondent's discharge in bankruptcy.

Conclusion.

For all of the reasons above stated, petitioner respectfully submits that the decision of the Circuit Court of Appeals in this case should be reversed.

Respectfully submitted,

Frederic Burnham,
David F. Rosenthal,
Orville W. Lee,
Richard Mayer,
By Richard Mayer,
Counsel for Petitioner.